

## Fraud Interpretation and Disclaimer Audit Opinion: Evidence from the Solomon Islands Public Sector (SIPS)

### Abstract:

**Purpose** – Financial Transactions Fraud (FTF) and Financial Statements Fraud (FSF) grew exponentially during the last decades coupled with complex and sophisticated technological developments. This study investigates the practitioners’ interpretation of fraud with recurring audit issues in the Disclaimer Audit Opinions (DAOs) reports within the Solomon Islands Public Sector (SIPS).

**Design/methodology/approach** - The empirical study involves qualitative data analysis. The analysis alongside theoretical developments is informed by the “fraud triangle” theory.

**Findings** – The research results revealed the practitioners’ acknowledgement of financial statement Fraud, Financial Transaction Fraud and fraud in the SIPS, as generally prevalent and aligned to some components of the fraud triangle theory. This study is sceptic about the good intentions of the International Public-Sector Accounting Standards –Cash-basis (IPSAS) framework and favours the Provincial Government Act 1997 and the Public Finance Management Act 2013 (PFMA) requirements. It further suggests that fraud is positively linked to repeated audited report issues and the executive management when DAOs issues appear repeatedly in annual audit reports.

**Originality** – This study contributes to the literature on fraud and attempts to link the interpretation of fraud with recurring audit issues in the Disclaimer Audit Opinions (DAOs) reports in the Solomon Islands Public Sector (SIPS). It views fraud awareness and knowledge from the perspective of the audit practitioner. There is an increasing need to understand how fraud knowledge impacts decision making and the actions of auditors and others, an area that is underdeveloped.

**Paper type:** Research paper

**Key words:** Solomon Islands, Auditing, Fraud, Financial Statement Fraud, Disclaimer Audit Opinions, Public Sector

# **Fraud Interpretation and Disclaimer Audit Opinion: Evidence from the Solomon Islands Public Sector (SIPS)**

## ***1. Introduction***

The literature on fraud has evolved over time from the pioneering publication of “White collar crime” by Sutherland in 1937 (Lokanan, 2015), and “Other peoples’ money (Fraud Triangle)” (Cressey, 1953) to more recent studies (see Pickett and Pickett, 2002; Gottschalk, 2010; Free, 2015; Albrecht et al. 2015). Financial related frauds impact the growth of corporations, public sector developmental activities and programmes (Albrecht et al. 2015). It exists in many forms, such as cyber-enabled frauds to Financial Statements and Financial Transaction fraud. Global business losses, attributed to financial fraud, were estimated from USD2.9 trillion (Dorminey *et al.*, 2010) to USD3.5 trillion in 2014 (Free, 2015). According to Albrecht *et al.* (2015) financial statement fraud is mainly a top-down form of fraud that impacts negatively on individuals, organizations, and society. This remains so if there are weaknesses that can be exploited for gain, and where companies and other organizations, as well as private individuals, will be taken advantage of (Pickett and Pickett, 2002). In a small economy, like the Solomon Islands, fraud is a huge concern. For example, the Office of the Auditor-General of the Solomon Islands (OAGSI) chooses ‘missing documents’ in place of financial fraud on SBD60 million unaccounted funds, which was only 10% of an audit sampling (Cohen, 2014).

This paper investigates whether fraud is linked with Solomon Island Public Sector frequent issue of DAOs. This was done using interviews with practitioners (auditors and accountants) to better understand their interpretation of fraud with recurring audit issues in the Disclaimer Audit Opinions (DAOs) reports within the SIPS. This study makes a valid contribution to the academic literature because of the understanding of how a technical concept (such as ‘fraud’) is being interpreted, and applied by practitioners, is still under-developed. Similarly, at the methodological level, this paper makes an important contribution by engaging with practitioners and shedding light on the operation of audit practice, something which much of the prior research has avoided. This paper also provides evidence on the operationalization of audit standards, regulation and good practices in the public sector, which is seldom studied and from a unique jurisdictional setting. According to Henning (2009), fraud can be defined as an intentional perversion of the truth for inducing another person, in reliance upon it, to part with some valuable thing belonging to him, or to surrender a legal right. Therefore, for fraud to occur there must be an act of dishonesty, a gain to the committer and a loss to the victim, which can be a system, an individual etc. (Ohalehi, 2018). Throughout this paper, the term “practitioners” was used interchangeably as participants, professionals, experts or interviewees. The examined frauds are informed by the “fraud triangle” theory.

## ***1.1 Research Background***

The small nation, known as the Solomon Islands, was a former British Protectorate since 1890s until it was accorded its political autonomy in 1978 (CIA, 2007). Transparency International (2016) ranked the Solomon Islands 72 out of 176 in its annual corruption perception index. The index implied that among the 176 ranked countries, the Solomon Islands ranks as corrupt, because a lesser ranking indicates the less likely it is that a country is corrupt. On the public sector corruption indicator, the country is ranked 42 out of 100 where 100 is very clean (Transparency International, 2016). Again, in both ‘perception’ rankings, the country had positioned itself in the midpoint scores generally. Furthermore, an in-country study in 2016 also revealed the SIPS as very corrupt; with a lack of morale, planning, leadership, law enforcement and accountability. The SIPS is funded by an annual budget as legislated under respective appropriation Acts of Parliament. It is governed by the Public Finance Management Act (PFMA) 2013 and implemented by a second-tier government of nine provinces with the intention to fund services and community development initiatives to 80% of the rural population.

Despite these legislative expectations, the actual benefits of the provincial grants have not filtered into the rural populace (Suluia, 2012; MDPAC, 2016). The disbursed grants to the SIPS are managed by the respective Provincial Governments (PG), or government ministries, and there are requirements that they are to be accounted and audited annually, as required by the Office of the Auditor-General of the Solomon Islands. Historically, SIPS have never had their annual financial statements submitted, and/or prepared for auditing, for the period from 1993 to 2008. The same applies to the national accounts (RAMSI, 2013). However, since 2003, the OAGSI received external expertise and resources to commence the annual auditing of the SIPS accounts to date (RAMSI, 2013; Cohen, 2014). Between 2008 and 2014 the auditing of these accounts illustrated a pattern of audit issues that have repeatedly recurred over this same period, and have attracted the FSs to be issued with DAOs under the international auditing practice (Sawaneh and Puri, 2014).

Against this backdrop, this study aims to examine whether the underlying fraud is linked to the repeated audited reports’ adverse findings of the SIPS. We investigate the SIPS professional practitioners around their fraud experiences and expose what they confront with the FS preparation and audit, and how those experiences relate to a pattern of the continuous issue of DAOs in the audited FSs of the SIPS. We carried out this investigation using a case-study to provide an in-depth analysis of practitioners’ views and their perception on FTF and FSF, in general, within the SIPS context. Based on this background, this study focuses on the outcome of the SIPS audited reports and how those reports have been impacted by the DAOs, accounting framework, disclosure and their possibility of financial fraud commitment.

The context of the SIPS is confined to the national government and the nine provincial

governments that produced financial statements for statutory audit on an annual basis. The others, more than twenty government ministries, have not been producing any financial statements on an annual basis (Clark and Levy, 2012a) despite being headed up by government ministers and ministerial financial controllers. This trend supports the SIPS definition, as the study concentrates on the audited reports that relate to the DAOs reports and the fraud within these contexts.

## ***2. Related literature on Financial Statement and Transaction Fraud***

During the past decades, a substantial amount of academic studies has been carried out on fraud in general and financial statement fraud (FSF) in particular (Hogan et al. 2008; Zhou and Kapoor, 2011; Woolley, 2016). However, these studies have looked at the causes, detection, determinants and consequences of FSF, as well as how FSF can be remedied, particularly, its increasing adverse impact on the global economies. This has made FSF a study of interest for regulators, policy makers and researchers.

The US Generally Acceptable Accounting Practice (GAAP) defines FSF as “any undisclosed intentional or grossly negligent violation of GAAP” (Hopwood et al., 2012, p.11) while Rezaee (2005, p.279) refers to it as a “deliberate attempt by corporations to deceive or mislead users of published financial statements, especially investors and creditors, by preparing and disseminating materially misstated financial statements.” This can be related to when financial statements are furnished with untrue financial information (Zhou and Kapoor, 2011). Alternatively, FSF schemes can be done in the form of improper revenue recognition, account misappropriations, under or over statements and ‘other miscellaneous’ techniques (Hopwood et al., (2012). They further extend it to the fraudulent financial transaction (FT) processing when an account balance is intentionally processed or modified. There are also factors, such as the fact that an audit firm’s reputation may affect the quality of conducted audits leading to fraudulent financial information (Hogan et al., 2008). In such a case as this fraudulent information, such as the lack of accounting supporting schedules in an accounting system general ledger, which is used to support financial statements, can also be considered as fraudulent transactions. Repeatedly, corporate scandals and collapses results from FSF. The 2008 global financial crisis partially resulted from the US’ Lehman Brothers USD50 Billion FSF (Lokanan, 2015). Similarly, Japan’s largest corporate scandal, by Toshiba in 2015 was a result of the USD1.2 billion FSF (Rahman and Marc, 2016), and Enron’s impaired USD63.4 billion assets resulted from numerous FSF (Benston and Hartgraves, 2002). Interestingly, these FSF trends have not been in decline since the enactment of the Sarbanes-Oxley Act in 2002. Rather, they seem to have increased by about 140% according to the 3,000 corporate officers surveyed by Hogan et al. (2008).

Similarly, the SIPS financial accounting reporting disclosure intends to convey to voters,

taxpayers, donors and other interested parties around the status of financial management and performance. FSF is possible even if the SIPS have mandated processes, and they neglect the conventional financial reporting framework, leading them to what has been described as “abuse and fraudulent and corrupt practices” (Fatai, 2005, p.iv). As conveyed by Brown (2013, p.205) the “financial accounting shortfall resulted in corruption, fraud, inefficiencies, theft and waste”. The Parliament Committee Secretariate (2015, p.12) also echoes similar concerns over the “widespread lack of compliance with statutory requirements by the national government ministries and agencies, provincial governments, and the capital’s city council”. The Committee has also registered the frustrations of the OAGSI to be able to see systemic failures of government accounting breakdowns in all levels of the government. Sawaneh and Puri (2014) identify 663 audit issues found in the provincial financial statements, since 2008, with some accounting disclosure issues appearing more than 40 times in the period. The national government accounts also face a similar or worse situation, which OAGSI revealed in the 2013 annual reports (Cohen, 2014). Some attributed the situation to a lack of training conducted in provincial government, for example (Sawaneh and Puri, 2014). However, Hardman (1984) highlighted the shortages of both the practitioners’ added value, and the accounting savvy of provincial treasurers, in the financial preparations in the broader SIPS.

### ***2.1. Accounting Disclosure Requirements - SIPS Reporting Framework within the Laws***

The SIPS FSs are prepared using the Public Financial and Audit Act (1978 PFAA-now repealed) and the recent enactment of the 2013 Public Financial Management Act (PFMA). The PFMA repealed the entire 1978 PFAA except for the powers of the OAGSI to conduct audits on SIPS FSs. The repealed 1978 PFAA on the other hand is silenced in stating the accounting framework requirement to prepare the national accounts. Section 38 of the repealed Act requires FSs such as assets and liabilities, receipts and payments, comparative figures, and other statements to be submitted for statutory audits (National Parliament of the Solomon Islands, 1996). Furthermore, Section 77 of the PFMA requires that the Accountant General should submit to the Minister responsible and the OAGSI of the Government’s balance sheet the assets and liabilities, statements of sources of funds, revenues and expenditures and other various governance statements (Solomon Islands Government, 2013). In mid-2003, the country’s annual national accounts were only submitted to the National Parliament since 1989 (RAMSI, 2013), and currently national annual accounts were presented at least up to 2013 financial year, as at 2015 year end (Cohen, 2015). Comparatively, Section 41 of the 1997 Provincial Government Act (PGA) requires that Provincial Executives prepare financial accounts of sums paid and received, and a balance sheet of assets and liabilities among other statements (National Parliament of the Solomon Islands, 1997). Clearly, both the PFMA and the PGA require balance sheet items to be disclosed and reported. Despite the requirements of the PGA, for example, provincial governments revealed that 135 FSs were not prepared by the provincial governments for auditing from the years 1993 to 2008 (Sawaneh and Puri, 2014).

In 2010 and 2014, the provincial and national governments adopted the IPSAS<sup>1</sup> Cash-Basis accounting framework, respectively (Sawaneh and Puri, 2014). Global public-sector reform

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<sup>1</sup> Subsequent use of the IPSAS term in this study refers to the IPSAS cash-basis framework unless otherwise stated.

institutions support IPSAS as a driving force to address systemic corruption and the wastage of public resources in the developing countries (Sanderson and Van Schaik, 2008). They also warned that developing countries will face the high costs of awareness, and the training of accountants to operate the IPSAS framework. With the exceptions of the statement of receipts and payments and cash-flows, the statement of assets and liabilities is not to be disclosed as primary FSs elements. The former statements are treated as a mandatory requirement (Schaik, 2014). However, the onus to ensure that IPSAS complies with a fair presentation of the FSs lies with the Supreme Audit Institution (SAI)<sup>2</sup>. Schaik (2014) further points out that the audit, on any government consolidated accounts, poses a further issue where other government reporting entities comply with other frameworks, such as the International Financial Reporting Standard and intra-transactions keeping. Sawaneh and Puri (2014) further highlighted that between 2010 and 2013 a total of 20 accounting trainings have been conducted including IPSAS. This composed of 45 accountants attending 11 accounting trainings and 9 trainings on the accounting information systems, which were attended by 27 professional staff.

## ***2.2 The authorised auditor***

Section 108 of the Solomon Islands Constitution provides for the establishment of the constitutional position of an Auditor-General (Solomon Islands Government, 1978). The Office of Auditor General in the Solomon Islands is empowered to audit the public offices, ministries, courts, authorities, town council, provincial governments among others. The office was staffed with twenty-seven audit staff at the time of the British exit (Clarke, 1985), but in the late 1970s it changed to virtually no Auditor-General with only a senior staff member and a cleaner in mid-2001 (TRC, 2013). However, a regional intervention led by Australia and New Zealand in mid-2003 restored many other internal institutions, including the OAGSI, to more than 30 auditors as of 2008 (RAMSI, 2013). Given the absence of auditing standards in the Solomon Islands, OAG chooses to comply with the International Auditing Standards (ISA)<sup>3</sup> to audit its government clients. While his work is not to detect fraud, or is not a bloodhound (Rodda and Cosserat, 2009), ISA, however, demands an auditor to state where fraud possibilities exist under ISA 240 (IFAC, 2009). The ISA 240 enforces that an auditor's primary auditing goal is not to look for fraud, but to give assurance of the financial accounts (IFAC, 2009). However, the demise of the auditing firm Andersen in mid-2000's enforces the fact that auditors are blameworthy for their negligence in not detecting frauds (Lohse, 2002). OAGSI audit efforts over the years can be connected to Tomasic's (1992, p.201) view where "sometimes governments are slow to respond to realities of corporate frauds and have preferred not to intervene even when problem matters are the subject of detailed official investigations", in which governments have not been very supportive of the auditors' findings.

## ***2.3 Disclaimer Audit Opinions –DAOs***

The audit opinions of the SIPS FSs are issued by the OAGSI when conducting the assurance services (even if the accounts are outsourced for auditing). With the lack of there being in the

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<sup>2</sup> This is the institution that governs global Auditor-General Offices.

<sup>3</sup> ISAs are issued by the International Federation of Accountants Board. See: <http://www.ifac.org/sites/default/files/downloads/a012-2010-iaasb-handbook-isa-240.pdf>

Solomon Islands both accounting and auditing framework standards (Hauriasi and Davey, 2009), the OAGSI is guided by the ISA to perform its functions. An unmodified audit opinion implies that a FS being audited complies to an applicable accounting framework in all material respects (International Federation of Accountants, 2009). Whereas a modified audit opinion is “based on the evidence obtained, [and] the financial statements as a whole are not free from material misstatements” (IAAS Board, 2016, para.17). This extends to the inability to obtain supporting audit evidence. Further, a modified audit opinion can be issued as qualified, adverse or as a Disclaimer of Audit Opinions - DAOs (IAAS Board, 2016). These opinions inferred that audit issues were found, and therefore some limitations were imposed on the opinions with explanations that users or readers can rely on them with caution. The DAOs are generally not found to be uncommon in corporate practices (Tahinakis and Samarinas, 2016). However, they are practically common in the SIPS financial accounts over the last 20 years. and are also found in neighbouring Vanuatu for the 2005 -2009 audited financial accounts (Path, 2012). Such audit opinions contain the most severe audit issues, if not the worse form of any audit opinion, which forbids any reliance on the financial accounts being audited for decision making. Davis (2004) clarifies that entities with such opinions such as DAOs signified issues of going concerns, funding applications issues, and regarded them as not useful, and there is the inability of reliable data to back up the numbers. For companies that are listed on stock markets in developed countries, DAO, whilst rare, has multiple effects including the plummeting of share prices (Frishkoff and Rogowski, 1986), adverse economic reactions (Hajihosseini et al., 2015) or they have reflected lower management integrity, earning manipulations and weak governance structure (Chen *et al.*, 2013). Conversely, Barberis et al. (2000) found that auditors do issue judgemental errors when issuing final audit reports. Davis (2004) on the other hand, argued that there were instances of auditors issuing opinions with a lack of independence, going concern doubts, scope limitation, and significant uncertainties.

## ***2.4 Theoretical Development***

This study is underpinned by Cressey’s (1973) fraud triangle theory. In the study entitled “Other People’s Money”, Cressey interviewed convicted corporate embezzlers and summarised the embezzlers’ hypothesis as: *“trusted persons become trust violators when they conceive of themselves as having a financial problem which is non-shareable, are aware this problem can be secretly resolved by violation of the position of financial trust, and are able to apply to their own conduct in that situation verbalisations which enable them to adjust their conceptions of themselves as trusted persons with their conceptions of themselves as users of the entrusted funds or property”* (Cressey, 1973, p.30). Overtime, the Cressey’s theory developed to what is now known as the fraud triangle and was embedded as Perceived pressure, Rationalisation and Perceived Opportunity.

### ***2.4.1. Perceived Pressure***

Cressey (1973, p.34) ‘considers that a financial problem which confronted him [fraudsters] could not be shared with persons who, from a more objective point of view, probably could have aided in the solution of the problem’. The non-shareable problem refers to financial issues brought

about by the activities of say gambling or an excessive lifestyle. Cressey believed that trust violators driven by those social problems can turn to employer's cash or assets to ease their problems, or they go on to claim unfairness from their employment treatment or working conditions to support their violations. Perceived pressure is more noticeable than the other two components despite the opportunity component, more commonly found in corporate culture, as a fraud enhancer (Ohalehi, 2018; Yekini et al, 2018; Schuchter and Levi, 2016).

#### **2.4.2. Perceived Opportunity**

The 'perceived opportunity' is referred to as an employee's action to commit fraud, as a result of non-shareable problems. According to Cressey (1973), it takes an employee two ways to commit fraud through the general information and technical skills learnt from the organisation. These refer to accountants using their position to alter things like invoices or manipulate financial statements, or a banker manipulating deposits from customers, etc. (Cressey, 1973). Albrecht and Albrecht (2003) in Hogan *et al.* (2008) indicated that a fraud opportunist utilises control weaknesses and accounting anomalies, while Albrecht and Romney (1986) in Hogan *et al.* (2008) later opposed it as not being the underlying case. Opportunists often join employment to commit fraud with the knowledge gained from organisational resources like computer systems (Lokanan, 2015). Everett et al., (2007) attribute it to the ineffective practice of accounting applications, giving the right ingredients for opportunists, while Lorde *et al.* (2016) strongly argues that frauds committed under this category were made possible by persons with economic hardships or personally advantageous positions.

#### **2.4.3. Rationalisation**

Cressey (1973, p.94) argues in this final component that "rationalization is not an ex post factor means of justifying a theft that has already occurred...rather ...a component of the crime before it takes place; in fact, it is a part of the motivation for the crime". Offenders or criminals commonly realised that their morals have been breached in the initial fraud commitment then become normalised through repeated frequency resulting in the subsequent inability to repay. Dellaportas (2013, p.32) advocates rationalisation as "the lack of feelings and indifference expressed by offenders to justify any guilt arising from their misconduct", as most occupational or organisational frauds incidences are viewed as acceptable by those committing them. Murphy and Dacin (2011) regards this attitude as a "relative mystery", while IFAC (2009, p.167) sees rationalisation as either committed employees being put under pressure, or are voluntarily set to commit fraud. Further, Roden et al. (2016) refers to managers' unrealistic financial forecasts as fraud by accounting principles or accounting estimates determinations. Rationalised frauds are often blamed for the lack of financial knowledge in board membership (Skousen and Wright, (2008) in Roden, Cox and Kim, (2016)). Others commit frauds and rationalise them by the neutralisation attitude to shield off such guilts (Stout (2007) in Lokanan, (2015)). Murphy and Dacin (2011) attribute the lack of fraud awareness and economic gains as reasons to commit fraud, while some corporate executives have seen criminal acts as being a necessary part of their corporate job (Ball, 2009).



Yekini et al. (2018) provided evidence of organisational factors having significant influence on occupational fraud. Brytting et al. (2011, p.57) find attributed justifications as “everyone is doing it and it is for a good cause”, while Albrecht et al. (2004, p.118) concurred in capital market settings that corporate executives’ desire to do it to keep the stock price high. Murphy and Free (2015) seemed to suggest that an individual’s attitude or set of ethical behaviours allow one’s intention to commit dishonest fraud acts. In some circumstances, fraudsters initially committed fraud under a clean sheet, having no initial fraud record. They would also attempt to justify their actions, for example, being due to poor remunerations or poor working conditions or the inability to look after their general welfare (Yekini et al., 2018; Ohalehi, 2018). Cressey (1973) on the other hand, considered trust violators as being independent businessmen, long term violators and absconders with their own rationalisations. It must also be noted that Cressey (1973, p.102) defines “long-term violators as individuals who converted their employer’s funds, or funds belonging to their employer’s clients, by taking relatively small amounts over a period of time”. Their rationalisation was to avoid their families being hungry or getting poor. The second view by Cressey (1973) under this component was that fraudsters’ actions are necessary because the employer is not treating them well, for example, good working remunerations, and so resort to cheating their employer.

## ***2.5 Criticisms and further developments to the Fraud Triangle***

Several scholars introduced new insights to the Fraud Triangle over the years. For instance, Albrecht, Howe and Romney (1984) introduced situational pressures, perceived pressures and personal integrity with fraud scale findings. Hollinger and Clark, (1983) further aimed at discussing quantified fraud costs, work place conditions, and highlighted the latter as a key motivator for the frauds committed. In addition, Dorminey et al. (2012) argue that not all frauds were non-shareable, as perceived by Cressey, and introduced a new idea known as the money, ideology, coercion and ego/entitlement (MICE). They believe MICE is well placed with the global corporate events in the post 2000 corporate scandals. The diamond concept introduces the term ‘capability’ as the fourth component of the fraud triangle, which is attributed to the employee’s usage of their employees’ technical know-how to commit fraud (Wolfe and Hermanson, 2004). Ramamoorti (2008) publicises the ABC method with the view that advocates that fraud is being committed by bad apples (A) for which these bad ‘As’ consider collusion through the bad bushel (B), while ‘C’ implies a bad crop referring to fraud influence as being predominantly committed by a community culture. The former, despite its attempt to add ‘compatibility’, is not really adding to Cressey’s fraud hypothesis theory.

Free et al. (2007), on the other hand, contextualise the fraud triangle onto an organisational setting to include charismatic leadership, subverted management controls and permissive culture as their new insights. Other researchers, however, link corporate events to the fraud triangle. Roden et al. (2016), for example, link the fraud triangle and the corporate frauds of the US Securities Economic Commission to chief executive officers and the chairperson scandals, and refers to share options benefits as being tied to executive remunerations. Murphy and Free (2015) choose incidences of ‘instrumental organisational climate ‘and employees’ attitude to

commit fraud. They find rationalisation more prevalent than others in the fraud triangle. As a result, fraudsters also justified that it was situations labelled as a ‘special crisis’ that lured them to commit fraud. Dellaportas (2013) finds professionals who deceive victims influenced by the ‘special crises’ they are faced with but suggests further that proactive means such as training can be implemented to prevent fraud incidences. Dorminey et al. (2012) on the other hand, consider the fraud triangle as a model for the risk assessing of fraud risks and claimed it as just being part of any risk assessment plan.

### **3. Research Method**

The study adopts a qualitative approach. Primary data were collected using semi-structured interviews. Other sources of evidence, which include amongst others, the historical audited reports issued for the public sector Financial Statements (FSs), audit executive responses and management representation letters, base-line studies on the public sector, related media release and others were used to validate the findings. These were integrated with the discussions. Using the possible linkages between fraud, FSF, FTF and the DAOs, the study seeks to address the following research interview questions below, to obtain a better understanding of practitioners’ views and the perception on FSF, within the SIPS context.

1. What type of fraud do practitioners (auditor or accountants) meet in their professional career?
2. How do existing frameworks (accounting standards, relevant laws) play a significant role in the fraud process?
3. What are examples of FSF and FTF that are found in the recurrent audit issues in the repeated DAOs? and
4. What has been done to reduce DAOs within SIPS and the practical trends, if any?

A non-probability sampling was used to select research participants through 10 recorded interviews that were conducted to identify the research’s core themes which were developed from the data. An initial 33 interview requests were made, and 13 participants accepted to be interviewed; however, only 10 interviews were successfully carried out. These interviews lasted on average 60 minutes. It is acknowledged that the size of sample is not very large, but the fact that Solomon Island is a relatively small nation with an expected population of 680,806 in 2019 (Solomon Islands National statistics office, 2018). This explains the limited nature of the research sample size. The questions asked on DAOs were linked to the interviewees’ professional practices of financial statements preparations, audited results and fraud literature. We investigated the links between fraud and the recurring audit issues in the Disclaimer Audit Opinions (DAOs) reports within the Solomon Islands Public Sector (SIPS). Utilising the case-study methodology, we intend to bring the expressed perceptions of the SIPS’s practitioners to see what can be done differently, that might reduce the disclaimer audit opinions apart from the processes implemented over the years to improve the audit opinions within SIPS. The interviewees’ responses were analysed and linked with the existing literature. The research participants are professional practitioners and mostly SIPS accountants (one participant), advisors and auditors (nine participants) with professional experiences ranging from 5 to 20

years. They have a detailed knowledge of the study's interview questions, and seeking their professional views provides the study with a contemporary understanding of the participants and their depth of knowledge. These professional practitioners have prepared and/or audited the public sector FSs within SIPS.

### ***3.1 Research themes***

Four significant themes were developed from the data. The themes thus are presented and summarised as:

- Facing fraud as SIPS practitioners;
- Fraud viewed within the expected legal and accounting reporting frameworks;
- Fraud is viewed within the 'repeated' DAOs; and
- Fraud is viewed by looking up to the Executive Management/Authority.

#### ***3.1.1 Facing Fraud as SIPS Practitioner***

The outcome of the interviews revealed that participants agreed that fraud, in the form of FS, FT or other forms of financial frauds, has been identified in their professional career. Practitioners generally accept that fraud is identified when terms such as omission, deception or being misled are the cause of an event which provides an advantage/benefit to someone. Secondly, as practitioners, finding or detecting fraud is not part of their job when executing their statutory audit plan, as it is not their job. "Basically, auditors do not look for fraud when carrying out audit work but to assert that the accounts are true and fair, while on other hand, fraud is something that is intentionally done" (SIG10, 1). While (SIG5, 1) shares the experience of seeing some components of the FSs as being omitted from the FSs disclosures, and attributes these omissions as fraud during audit field work executions. Another interviewee expresses the following: "In an accounting transaction, fraud is stealing or seemingly conducting abnormally the organisational rules, regulations and so on. For example, if a transaction falls outside of these rules and regulations, this therefore is deemed as committing fraud" (SIG8, 1). In addition, (SIG5, 1) enforces the practice that departments<sup>4</sup> should be given enough opportunity to respond to audit issues to reduce fraud prior to finalising a management representation letter<sup>5</sup>. When a client has had an insufficient response time to their management representation letters, fraud can be blindly assumed.

Some instances, however, pointed to fraud as being enhanced by political interferences that contributed to the outcome of SIPS FSs or FTs fraud incidences. "Revenue collection was carried out by both the department senior officers and the elective executives including the political head. These officers and political representatives held on to department's receipt books, were issuing income receipts and personally spent the department's revenues obtained from the

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<sup>4</sup> Department is used interchangeably to imply government ministry or provincial government.

<sup>5</sup> In auditing standard, it refers to the letter that contains the issues found during the audit.

corporate business licenses including logging companies” (SIG6, 1). Practitioners also identify frauds through what they find in the FS disclosures and other processes, or from accounting standards underpinning the FS disclosure. Similarly, there are fraud indicators that can be identified with the implementation of audits or identifying them within a FS itself. As one response put it: “A problematic accounts source is a nursery ground for fraud. This is also extended to the lack of response to the third-party confirmations. This is fraud to me practically” (SIG3, 1).

### ***3.1.2 Frauds view within the expected legal and accounting frameworks***

The feedback sought from the interviewees revealed significant support for the legal requirements, such as the PFMA and the PGA with their supported financial instructions (FIs) or financial management ordinances (FMOs) as not contributing to fraud conduct. The law requires the disclosure of the profit and loss and balance sheet items as requirements. The IPSAS Cash-basis accounting framework, however, is supported the same as assisting the possibility of fraud conduct in both FS and FT frauds. “The varying disclosure requirement basis between the IPSAS and the FMO has promoted fraud. The former, which is the professional framework, does not support full disclosure of financial statement transactions. This framework allows frauds to be hidden, as it is easy to hide fraud in the financial statements, which include the balance sheet items, considered as an optional disclosure” (SIG1, 3). While another interviewee put it as: “Based on the definition of fraud and the requirement of the IPSAS Cash-basis, the omission, or the optional disclosures of some of the balance sheet items, fall onto the fraud definition because users of the financial statements have been deceived or something has been omitted. The FMO on the other hand, requires the disclosure of everything and if this legal framework was not adhered to, fraud had occurred regardless, as some information has not been disclosed” (SIG2, 3). The PGA and PFMA require both the FMO and the FIs, respectively. These laws require that the balance sheet items be disclosed and produced in separate FSs. With IPSAS, it requires the optional disclosures of all balance sheet items as ‘encouraged disclosures’; the interviewees, after years of professional conducts and experience, revealed the following: “The 2013 PFMA, in fact, requires the compulsory disclosure of the balance sheet items which conflicts with the professional accounting standard, IPSAS, and hence the SIPS should have used the IPSAS accrual-basis other than the IPSAS cash-basis. It is now time that the public-sector authorities should find ways to agree to introduce the IPSAS accrual-basis to match the gaps between the law and the accounting framework. As practitioners, the gap seemed to be fraud by its definition. When the law requires the balance sheet to be disclosed, it basically referred to accrual accounting” (SIG5, 3).

The reporting gaps between these two requirements are noteworthy and obvious as being negatively impacted by the genuine intentions of the accounting standard setters and legislators. An interviewee chooses to divert the negative issues to the wider SIPS executive management as another set of contributory factors to the current reporting fiasco. “Because of the lack of monitoring, the executive management seemed to play around with the asset acquisition/recording and financial statement disclosure, and because of the understanding about optional disclosure, executive management can take advantage with the lack of enforceability to abuse assets acquisition as an example. Auditors conduct, on the other hand, provides checks to

ensure that asset transactions and physical presence are verified for record completeness to reduce fraud, even if some standards require an accounts optional disclosure. The presence of fraud cannot be nullified because they are not monitored; fraud seemed to take precedence when controls or monitoring issues seem not to have been given some attention” (SIG7, 3).

### ***3.1.3. Fraud is viewed within the ‘reappearance’ to disclaimer audit opinions issues***

The DAOs, as discussed in the literature review, signify its severity and its rarity in practice. This specific theme is interesting to the study as the DAOs both reoccurred over the years in the SIPS and serves as an extreme in the auditing profession. Given the continuity of this magnitude, this study sees it as an additional test of any possible nexus between the trend and the re-occurrence of the DAOs and their supporting contents.

Interviewees agree that fraud is certain when the audit issues or internal control issues impacting DAOs have abnormally appeared annually based on the SIPS financial statement audit reports. Others seem to suggest some specific issues, such as a lack of internal control monitoring, or that executive management has done little to remedy the DAOs issues. “The audit recommendations are dealt within executive managements who also have no clue on accounting knowledge, and therefore will not understand whether the issues have been addressed or not. So, when audit issues reoccurred annually it implies that frauds have also reoccurred” (SIG3, 4). One other practitioner divulges feedback by expressing a similar view. “Not every issue is fraud. However, most issues reflect management failures; they promised to resolve them through executive responses but had not implemented them...but other issues yes, and they are fraud. For example, procurement operational issues which were failed by the management, as these issues reoccurred as audit issues in the procurement issues” (SIG10, 4). Several interviewees provided varying but diverse responses, such as the fixed assets register, for example, reappeared as audit issues annually being a non-response to record keeping or the updating of assets (SIG4, 4). On the other hand, some suggestions seem to point to their being little attention given to internal controls by the management: “The frequency of the audit issues that re-appeared over the years seemed to indicate the likelihood of fraud having occurred and reoccurred. This fraud likelihood extends to the fact that weak internal controls, having been prevalent, are resulting in the re-appearance of the audit issues over the interested period. On the other hand, the management (executive included) had paid little attention to the audit issues resulting due to their re-appearance” (SIG7, 4).

### ***3.1.4 Fraud is viewed by looking up to the Executive Management or Authority***

This final theme follows the final RQ to redirect away from the norm as required by the auditing standards. The norm requires auditors to issue their annual audit issue findings to the management or the department executive management in the form of a management representation letter. The executive normally responds to the auditors with remedial plans to

counter the ways to resolve the issues by outlining the steps suggested to resolve the audit issues. The study interviewees, however, given years of auditing and accounting experience provide insights on what could be done given the current trend of the reappearance of the SIPS audit issues. Two responses have suggested that prompt fraud investigations need to be carried out. “Firstly, the internal audit Department of the government needs to be active and strengthened by conducting spot checks on monthly, bi-monthly or quarterly government operations. The internal audit can pick up issues or detect issues at this level. Secondly, there are suspicious issues documented on the outcome of the OAGSI’s work and a fraud investigation needs to be called up to do the investigation and using existing law to conduct a full investigation on the concerned department” (SIG8, 5). But training seemed to focus towards accountants who have either no technical knowledge or no interest to implement the earned knowledge from this training. This is seen as the reason for failing to implement the remedial plans. “The problem with so many trainings conducted on the public-sector accountants is that they have been done to officers who have no idea about accounting, as accounting is a technical area on its own” (SIG5, 5).

Management on the other hand should not isolate themselves with the audit issues reported. They should be key players around the non-implementation of their own agreed executive remedial plans to the audit issues, or it could represent their management incompetency. “Something is wrong with the executive management that is looking after the executive responses and the operations of the government or the organisation. When the executive responses remain outstanding for years, we may like to consider the incompetency of the senior officers who are placed to look after the departments” (SIG1, 5). A suggested area of investigation and issuing penalties for non-performing accountants are conveyed by some interviewees. This ensures creating a responsive practitioner who can be kept alert to departmental non-compliances or their own audit remedial plans. “If the audit issues re-appeared annually as they are now, some penalties need to be implemented on the accountants because a law was breached. What is left for us to do is to act on the law by disciplining the accountants’ concerns. In a way, the relevant authorities have not implemented laws when they are breached by exercising their powers” (SIG3, 5). One interviewee chooses to relate the fraud conduct to the executive management, being accountable officers and stewards of departmental operations. “The auditors should establish a mechanism to communicate with the public-sector accountants to help reduce the audit issues, as well as recommending the removal of accountants through the accountable officers in the public sector. When accountable officers, such as provincial or permanent secretaries, are not exercising the removal of officers they are concerned with, it seems that they are entertaining fraud conduct, as the audit results are reflected in the technical limitation of the staff” (SIG5, 5).

### ***3.2 Practitioners’ Exposed to Fraud***

As mentioned in the literature review, fraud definition and its elements offer the audit results of the FSs as being misleading to users, or decision makers, as a result of both intentional actions or inactions to gain an advantage from the accounting reporting (Hopwood et al., 2012). This advantage has benefited fraudsters, as some relevant FSs information has been omitted during annual FS preparations. The position of the practitioners is that they concurred with the fraud

definition, and an equivalent percentage explains how FS and FT frauds can be easily identified. This is particularly in the views of interviewees, as reflected by the 100% rating, given their enough practising experiences in accounting and auditing, of which some have more than twenty years' experience in practice.

90% of respondents provide fraud examples, such as government revenue balances that have not been fully disclosed in the accounts, accounts receivable balances that have either been undisclosed or unaccounted for, and the abuse of the accounting system and the maladministration of internal controls, etc. These responses have not been isolated and are anew. Researchers who documented the early 2000 corporate collapses (Benston and Hartgraves, 2002), and the post 2008 global financial crises (Hogan et al., 2008), have identified a similar pattern of 'cooked' accounting incidences in the Enron and Lehman Brothers collapses, respectively. In view of these, it can be easily agreed that there is a trend of 'other processes as contributing to fraud' by 60% of responses. This implies the SIPS accountants' or management executives' silence or inactions over auditors' recommendations.

The 'hard to identify fraud incidences' by 30% explains the practitioners in the auditing perspective, which audits only on executing an audit plan and programs. They only raise the circumstances where they think frauds have occurred or which are frauds possibilities (IFAC, 2009) despite the re-enforcement of lawsuit cases for auditors, such as the recent demised Andersen Firm failing to detect fraud (Lohse, 2002). The 20% rating identifies fraud contributory factors through politicians' interferences in the SIPS. This response comes about when the interviewees attempt to explain and justify the actual fraud incidences within the SIPS. This, however, supports the view by Tomasic (1992) where corporate frauds have been long neglected by governments, and is also relevant to the Solomon Islands' jailing of a Member of Parliament in 2013 and the suspension from duties of two<sup>6</sup> senior officers in the Ministry of Police, National Security and Correctional Services as examples of SIPS frauds (RNZ, 2013; PIR Editor, 2016). This is also consistent with Cressey's fraud triangle where positions of trust through employment have been violated by those occupying them.

### ***3.3 Accounting Framework as Catalyst to Committing Fraud***

The disclosure requirements expected from the law (PGA and PFMA), and the compliance to IPSAS as a professional reporting framework, identify the disclosure mismatch which is supported by the interviewees' responses. Whilst it may be agreed due to the varying degrees around the two mismatches and disclosure misconceptions, it must also be further noted that FS and FT frauds can also be made possible through the unreconciled accounting gaps.

Schaik (2014) acknowledges the IPSAS disclosures reporting gaps, while this study confirms

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<sup>6</sup> The Financial Controller and the Permanent Secretary

90% of the practitioners who identify the disclosure reporting gap as a possible fraud contributor. The practitioners' perceptions are consistent with the general fraud concept definitions (Pickett, 2011) that the non-mandatory disclosure of the IPSAS framework (Schaik, 2014) provides FS elements to be omitted, and hence has deceived FS users. This also supports the viewpoint of Everett et al., (2007) where opportunists capitalise on an ineffective accounting practice to commit fraud.

The other two rankings, however, (Encouraged: Omission is fraud and IPSAS as non-compliance to laws) of 60% and 70% respectively, follow the general justification of IPSAS as fraud stimuli. Whilst it does not specifically refer to the IPSAS's intention to encourage fraud per se, it is seen in the context of financial accounting reporting as infrequent or as none at all for some ministries of the SIPS (Clark and Levy, 2012b).

There is also a need to enforce IPSAS trainings, as the SIPS accountants have limited knowledge on reporting the financial statements prepared under IPSAS, as indicated by 30% of respondents. This on the other hand, does not reflect the numerous trainings implemented nationally (Sawaneh and Puri, 2014) and regionally by the regional learning institutions on IPSAS (PASAI, 2016). Nevertheless, this confirms the anticipated World Bank IPSAS training issues across the globe, such as training affordability issues (Sanderson and Van Schaik, 2008). One extreme response from participants is to design customised training for both auditors and accountants so that the expected ways and means to close audit issues can be consensually agreed together. However, the last 10% signifies the practitioners' response as not experiencing any fraud at least in the current running audits.

### ***3.4 Identifying fraud within Practitioners' engagements***

The SIPS annual FSs have their audit reports, since the 1980s, issued with DAOs. These audited issues repeatedly occurred annually and continued to do so up to the 2014 SIPS reports and are now unbecoming from a professional perspective. The practitioners agreed that FS and FT frauds occurred as represented by the higher responses of 90% and 100%, respectively. Interviewees provide examples such as the non-disclosure or incomplete disclosures of FT or FS items such as revenue, accounts receivables, non-current assets or missing documents as inevitably impacting the DAOs trend. They accepted the trend as significantly impacting the completeness of the SIPS annual financial statements reports, which confirms the fraud triangle's 'perceived opportunity' where FS manipulations were committed through official occupied positions.

The enormous agreement to the trend is the identification of fraud examples as being either FS fraud or FT fraud, which potentially align to respective concepts in the literature. Hopwood et al., (2012) generalise the fraudulent reporting schemes as inclusive of improper revenue recognition, account misappropriation or as an under or overstatement of FSs. The previous OAGSI in his annual SIPS report highlighted the fraud risks trends (Cohen, 2014), and is also supported by the current OAGSI where non-current assets remained as still unaddressed to date (Lokay, 2017).



A further significant portion, 90%, suggests that the trend of re-appearance of the audit issues as not being caught out by fraud, but rather by the attitude and work ethics of the management to comply to organisational procedures, and also to closing their agreed remedial audit strategic plans over the years. Their compliance to organisational job descriptions should have been questioned on the basis of this trend. This relates to Dellaportas' (2013) idea that fraud is committed from a lack of feelings to their society, as a result of their continuous guilt and misconduct, and is also described as a relative mystery by (Murphy and Free, 2015). And this further supports the occupational fraud terminology as advocated by (Ratley, 2016). The 20% figure represented by 'Neutral' implies the perception that they are not confident to reveal if the re-appearance of the same audit issues are frauds. Whilst there is a suspicion of fraud within the audit reports, the responses signify their role as not being one to detect frauds. This can be linked to where auditors have a fixed audit time frame to conduct their audit, and also the wordings such as missing documents, lack of supporting documents and missing executive minutes at auditees, which are typical and ongoing (Cohen, 2014; Sawaneh and Puri, 2014).

### ***3.5 Summary to Fraud Perspectives***

The study finds that fraud and its associated concepts such as FS and FTs frauds are acknowledged and can be easily identified. This identification applies to both FS preparations and the auditing of the same during practitioners' professional engagements. There are also the practitioners' general concurrences of fraud conducts bringing benefits to fraudsters or managers and hence their conduct (Hopwood et al., 2012).

While this present study confirms the literature, the study also contributes additional evidence that suggests further that when a public sector remains adamant to remedy compliance issues, and there is silence about audit recommendations, this illustrates attributes of fraud. This suggests, as among others, that there is 'political interference' in the SIPS operations or basically there is fraud in it's entirety. It is important to add that this applies to contexts like the study's context.

### ***3.6 Summary of the Accounting Disclosure Requirements***

Further to RIQ1, this study confirms the findings of Schaik (2014) around IPSAS disclosure gaps, which significantly stimulate fraud in the SIPS relating to its non-mandatory disclosure of assets and liabilities as optional disclosure. The omission of such items had brought FSs into to disrepute, as deceptive to FS users and decision makers (Pickett, 2011). Furthermore, it confirms a 'perceived opportunity' under the fraud triangle, as SIPS accountants did nothing to stop fraud incidences using their occupied positions. However, there are the correlating practitioners' responses that suggest that compliance to PGA and PFMA could minimise the fraud incidences given the mandatory compliances to disclose assets and liabilities. Therefore, these legal expectations can bring fraud conducts to a minimal.

### ***3.7 Summary of the Disclaimer Audit opinions (DAOs)***

The RIQ3 responses have demonstrated for the first time that DAOs can be seen negatively when it is both issued by auditors and that, its issuance continues for a repeated period of time. This study confirms as financial fraud and its related concepts when the same or similar audit issues appear unresolved and reappear repeatedly over a period without any attempts to remedy them or attend to them. However, it becomes a norm given their repeated appearances, and can be aligned to the 'rationalisation' component where fraudsters rationalise their actions as not being identified as fraud given the audit issues' frequency in this case. Furthermore, there are also additional insights to this study where management incompetence takes precedence over fraud. While these findings are conclusive in nature to the SIPS experiences, the literature reinforces that managers, who have no care for, or feelings about, society, continue to commit fraud and misconduct, see Dellaportas (2013).

### ***3.8 Summary on the linkages between Fraud and DAOs***

On the question of linkages between Fraud and DAOs, we find an overwhelming confirmation in the synergy between the two. According to the practitioners' judgments, the former conforms to its concepts if the latter carries audit issues that have either been neglected or have never been attended to. With such reoccurrences, and using SIPS governance performance and indicators, there is a positive linkage between the management executives who were unable to close their audit issues who probably have fears to address the DAO issues as a result of the political directions, or those who have committed their common fraud either by mutual or independent collaboration. This study has demonstrated, for the first time, that where the SIPS practitioners exercise conservatism in the direct use of the term fraud, in subsequent audit reports issued, is when DAOs have repeated audited issues. This professional conservatism agrees to ISA rules, but it has, however, sealed the truth of the SIPS fraud reporting to the FS users, decision-makers and the general public.

## ***4. Conclusion and recommendation***

This study seeks to extend knowledge on financial frauds by examining practitioners' interpretation of FTs and FSs fraud. Practitioners find that FTs and FSs fraud within the SIPS are prevalent. In view of their professional experiences, they find that the intentions of the IPSAS accounting framework have been diminished and thereby incentivize fraud conducts. Further legal requirements imposed to fully comply with accounting disclosures have been neglected which erred and can potentially allow omissions of some balance sheet components such as assets and liabilities. While the literature agrees with the practitioners' views, research interview question three seems to uphold a fresh perception that is not covered in the literature and the locality of the study. This is that those equivalent or similar repeated issues, which have been repeating over a certain audited period, suggest that fraud is being committed either by management or due to collaboration with political interference. This view suggests that it correlates positively in jurisdictions with a short supply of accountants, and a country with an adverse good governance ranking.

The study further suggests robust monitoring, continual training and oversight roles from the SIPS ministries and OAGSI to curb the continuity of unresolved issues in management representation letters. Others suggested, that having seen these unresolved issues going on for far too long, that they require reactive means such as special criminal investigations. The 'perceived opportunity' and 'rationalisation' components of the fraud triangle seem to suggest some direct linkages. Taken together, these findings suggest that repeated audited issues over a certain period and accompanied with the executive managements' ignorance to remedy the repeated audited issues, promote various forms of financial frauds in the SIPS setting.

This section addresses the concluding question posed to the interviewees in an attempt to find ways to resolve the audit issues that are innovatively sound compared to past practices. The following are recommended:

The OGASI legislative reform should be brought forward to cater and expand its functions. This is not to change their fraud detection perceptions (Tomasic, 1992) but to empower OGASI from its current inability to do and implement its functions effectively (Clarke, 1985; Clark and Levy, 2012b; Cohen, 2014).

Following on from the regulations, the practitioners recommend that the IPSAS accrual accounting framework be made compatible to current existing laws such as PGA and the PFMA. Their compliances are reducing these public sector frauds. There is also incompetent departmental management, as well as the inability of management who pay no attention to DAOs issues, and that they should be given appropriate disciplinary actions using the current PGA and PFMA regulations. While staff training, and the reshuffle and recruitment of the SIPS managers are vital, this study recommends further that the private sector model of corporate discipline should be implemented effectively by responsible authorities/agencies.

The current investigation is limited by some difficulties, such as samples from other sectors of the wider SIPS as not being forthcoming; and therefore, offer some limitations to the current expressed views. Other than that, despite the good intentions of IPSAS, its intentions are irrelevant for jurisdictions that have accountants who pay less attention to accounting procedures and accounting standard frameworks. Finally, this study is done in a third world country context which has historical issues with governance in the public sector. Future research should attempt to include fraud linkages on situations of repeated qualified audit opinions, and also further study might provide new insights on how local culture influences fraud incidents in either the private or public sectors in the Solomon Islands.

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